FINURA

MARKET COMMENTARY
JANUARY 2022

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INFOGRAPHIC: THE GLOBAL ECONOMY

China will be key to the growth outlook for emerging markets in 2022

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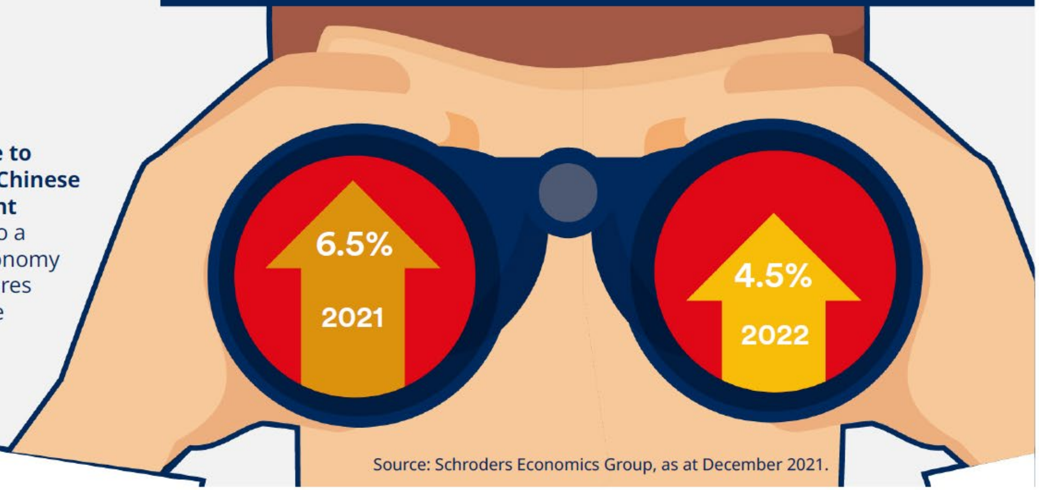
Much is riding on China for the emerging markets growth outlook.

There are two key uncertainties:

1. **The depth of the downturn** in the real estate sector.
2. **The degree to which the Chinese government responds** to a slowing economy with measures to stimulate growth.

Emerging markets GDP growth forecasts



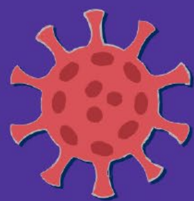
Source: Schroders Economics Group, as at December 2021.

Bank of England becomes first major central bank to raise rates

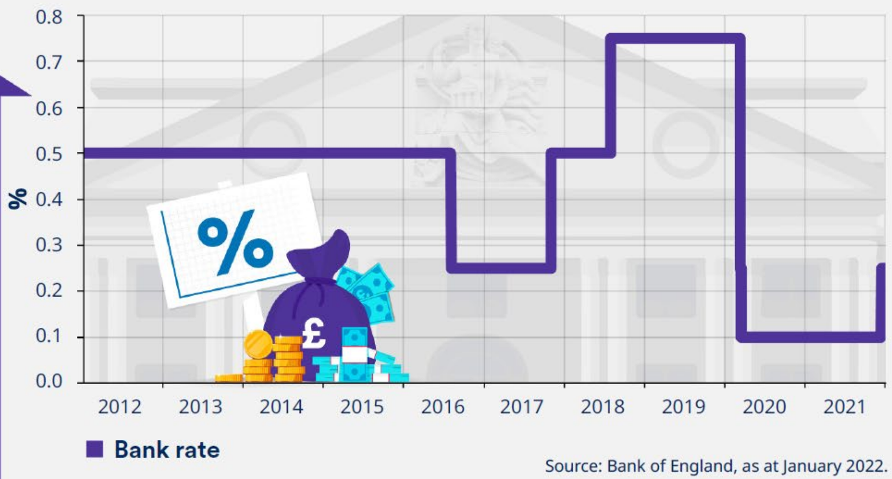
Read article here

The Bank of England has become the first major central bank to **raise interest rates since the pandemic.**

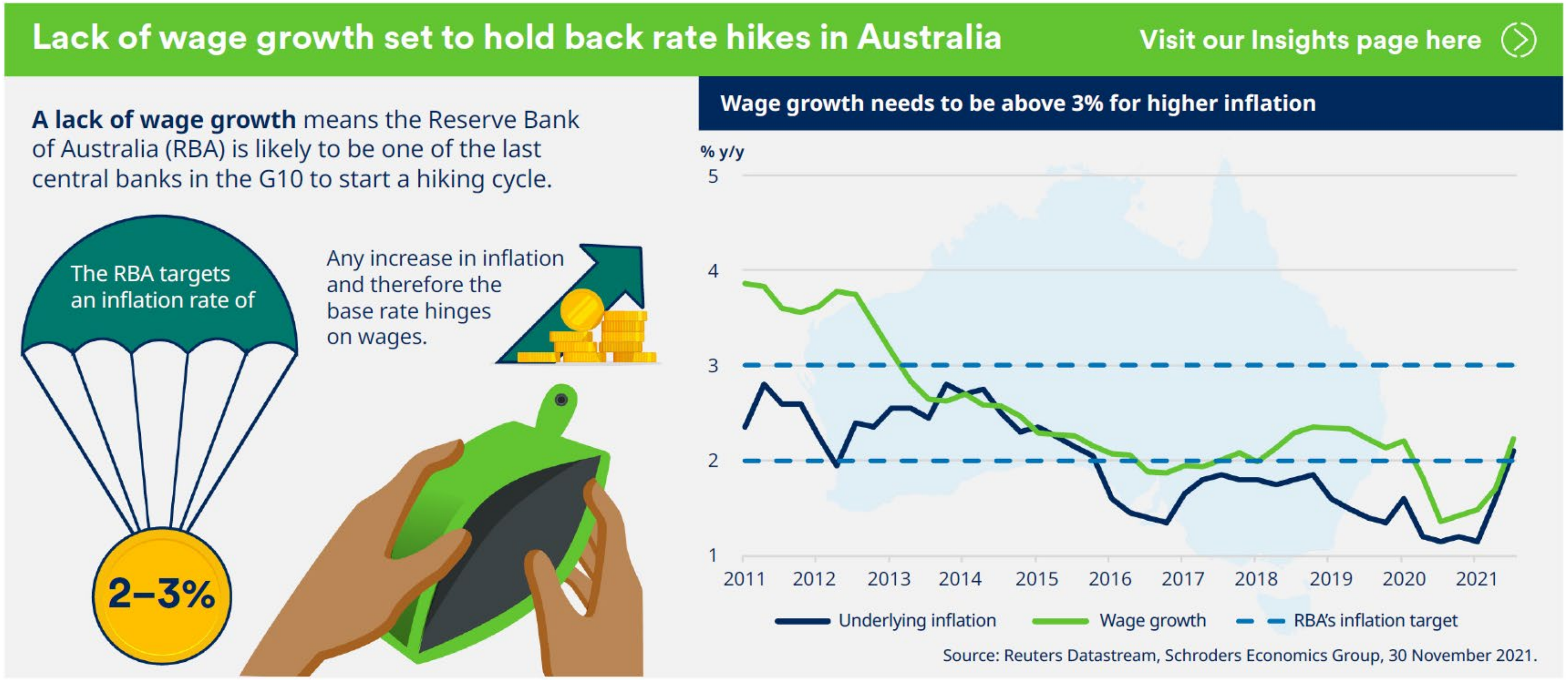
It has decided the risks of **higher medium-term inflation** outweigh those related to the Omicron variant.



Bank of England official rate



Source: Bank of England, as at January 2022.



Source: [Schroders as at January 2022.]

MULTI-ASSET INVESTMENT VIEWS

KEY

▲ Up from last month ▼ Down from last month

Positive | Positive/ Neutral | Neutral | Neutral/ Negative | Negative

	Category	View	Comments
Main Asset Classes	Equities	Positive/Neutral	The news on the Omicron variant has improved, but the Federal Reserve (Fed) is back in play. Whilst we remain invested for now, it remains to be seen how aggressive the Fed will be in combating rising inflation.
Main Asset Classes	Government Bonds	Negative	Despite the recent sell-off, valuations are still somewhat expensive relative to our models. Hawkish rhetoric by central banks solidifies our conviction on imminent tightening.
Main Asset Classes	Commodities	Positive/Neutral	The market has rebounded strongly as cyclical sectors outperformed. We stay positive as the balance remains tight with economies re-opening, but supplies restrained.
Main Asset Classes	Credit	Neutral	Fundamentals continue to improve, and we expect this to persist, translating into relatively low default projections in developed markets.
Equities	US	Positive/Neutral	We continue to favour the US given the strength of the recovery, however we are less positive on US technology stocks given sensitivity to rising yields.
Equities	UK	Neutral	It remains to be seen whether the UK equity market can outperform alongside strength in the British pound.
Equities	Europe	Neutral	We remain on the sidelines for now, as the region continues to suffer from subdued activity due to the impacts of Omicron.
Equities	Japan	Neutral	We expect market gyrations to continue to be driven by currency movements, with a weakening Japanese yen recently propping up the market. The response to Omicron will be key.
Equities	Global Emerging Markets[1]	Positive/Neutral	China's easing stance and cheap valuations outside Asia are supportive, but we remain cognisant of a "hawkish" Fed and a potentially stronger US dollar. Monetary policymakers are often described as hawkish when expressing concerns about limiting inflation.
Equities	Asia ex-Japan & China	Neutral	Authorities have begun to ease policy and stimulate selective parts of the economy. Despite this, markets will continue to be volatile and we remain neutral for now.
Equities	EM Asia ex China	Neutral	Supply side bottlenecks have begun to abate, but uncertainties persist, including the upcoming Korean elections.

[1] Global Emerging Markets includes Central and Eastern Europe, Latin America and Asia.

	Category	View	Comments
Government Bonds	US	Negative ▼	We expect the US yield curve to flatten and shift higher in time, driven by a maturing economic cycle and monetary policy normalisation. Valuations remain off our fair value estimation. Monetary policy covers measures taken by central banks designed to stimulate economies. Normalisation refers to interest rates being raised back to where they broadly were prior to Covid-19 and the phasing out of other policies implemented during the pandemic.
Government Bonds	UK	Neutral ▲	Gilt yields have moved up significantly in recent weeks as investors have bet on more interest rate rises against a backdrop of rising inflation. Upgrading on valuation grounds.
Government Bonds	Germany	Neutral ▲	With German bund yields recently returning to pre-pandemic levels, we have reduced the magnitude of our underweight. This comes despite a continued monetary divergence between the European Central Bank (ECB) and the Fed.
Government Bonds	Japan	Negative	We remain on the sidelines in Japan with little movement expected anytime soon.
Government Bonds	US Inflation Linked	Neutral	Leading indicators remain in expansion, inflation and growth data remain elevated, but momentum is slowing. With Omicron concerns fading, our medium-term view of higher inflationary pressures remains unchanged.
Government Bonds	Emerging Markets Local	Neutral ▲	Valuations and carry are compelling in local emerging market debt (EMD), with the emerging markets (EM) versus developed market yield differential trading at its highest levels since the global financial crisis. Many EM countries are also further along the path of monetary normalisation.

	Category	View	Comments
Investment Grade Credit	US		We expect stability or a slight drift wider in US IG credit spreads. Increased mergers and acquisitions (M&A) activity and leverage buy-out activity are likely to be factors that increase supply going forward. The credit spread is the margin that a company issuing a bond has to pay an investor in excess of government yields and is a measure of how risky the market perceives the borrower to be.
	Europe		European investment grade bonds still has scope to tighten a little further, particularly following the European Central Bank (ECB) meeting in December, which confirmed an expansion of the asset purchase programme.
	Emerging Markets USD		EM corporates continue to look attractive, but policy measures in China still need to be accelerated to boost sentiment. We also see value in the sovereign space.
High Yield Bonds (Non-IG)	US		Whilst we retain a preference for high yield across developed markets, valuations and higher future supply restrict our enthusiasm for the US.
	Europe		European high yield bonds offers slightly more compelling valuations, with potential upside driven by the continued divergence in policy support between the ECB and the Fed.
Commodities	Energy		Given the continued recovery and limited damage from the Omicron variant, demand remains strong and the deficit continues to bring inventories down further.
	Gold		Whilst we remain neutral, gold appears better priced against real (adjusted for inflation) yields, which may be attractive if we have reached peak Fed hawkishness.
	Industrial Metals		Ex-China demand is continuing to rise, while the policy stance in China turns more supportive. The focus on renewable energy also brings substantial long-term upside.
	Agriculture		There remains some upside risk from rising input costs, most notably in fertiliser prices, as the knock-on effect may results in a decrease in expected supply in 2022/23.
Currencies	US $	▼	We hold less conviction in the dollar's upward trend. The Fed appears to have reached maximum hawkishness with significant tapering and rate hikes already priced in.
	UK £		The market is pricing in a more aggressive stance from the Bank of England, however recent data shows UK growth may already be slowing.
	EU €	▲	With the Omicron threat fading and monetary divergence with the Fed priced in, we have upgraded the euro to neutral. Given recent developments, valuations appear mis-priced.
	CNH ¥		We expect a slowdown in exports and interest rate cuts to lead to a depreciation in the renminbi (offshore), something now being flagged by policymakers.
	JAP ¥		Intensifying US rate hike expectations and fiscal stimulus in Japan should lead to a further leg down in the Japanese yen. Fiscal stimulus involves government spending and taxation policies designed to support economies over the short term.
	Swiss F		Swiss franc rates are expected to continue to be even lower than Europe and as the Fed starts hiking, the low carry just becomes less appealing.

Past performance is not a guide to future performance and may not be repeated. The value of investments and the income from them may go down as well as up and investors may not get back the amounts originally invested. Source: Schroders, January 2022. The views for equities, government bonds and commodities are based on return relative to cash in local currency. The views for corporate bonds and high yield are based on credit spreads (i.e. duration-hedged). The views for currencies are relative to US dollar, apart from US dollar which is relative to a trade-weighted basket.

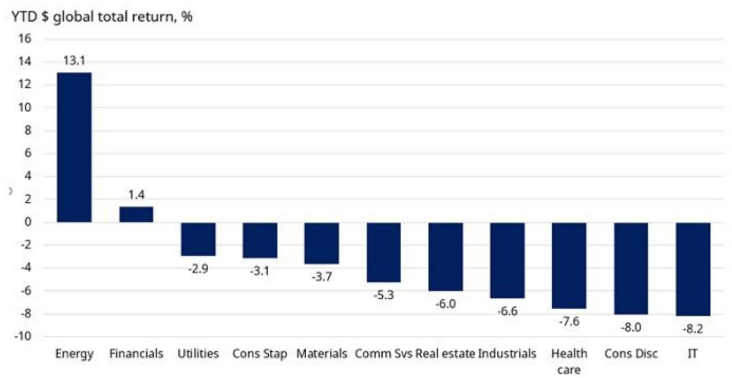
MARKETS REVIEW

A look back at markets in January when equities fell amid caution over the outlook for US interest rates and the uncertain situation in Ukraine.

THE MONTH IN SUMMARY

"The prospect of US interest rate hikes and Russia-Ukraine tensions meant there were few places for equity investors to hide in January as bond yields spiked. Growth-tilted sectors such as IT (-8.2%) and consumer discretionary (-8.0%) bore the brunt of losses. Meanwhile, rising inflation turbocharged energy stock prices (+13.1%)," Sean Markowicz, Schroders Strategic Research Unit.

Global sector returns year-to-date



Source: DataStream Refinitiv, MSCI and Schroders. Data to 31 January 2022 in US dollars.

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THE US

US stocks fell in January. Investors had already been eyeing expected rate hikes with caution when escalating tensions between the US and Russia over Ukraine added to worries, putting markets in reverse.

Comments from Federal Reserve (Fed) Chair Jerome Powell suggested a hike in March is extremely likely, underpinned by high inflation and a strong labour market. Chair Powell said: "reducing our balance sheet will occur after the process of raising interest rates has begun. Reductions will occur over time in a predictable manner primarily through adjustments to reinvestments so that securities roll off our balance sheet."

On the inflation outlook, he noted that, while the base case remains that inflation will decline substantially in the second half of 2022, there are risks that it could continue to surprise on the upside. In the meantime, early estimates put Q4 GDP growth at 6.9% (quarter on quarter, annualised), above expectations of a 5.5% increase.

The potential for sanctions to deter Russian activity in Ukraine pushed energy stocks significantly higher. Other sectors were largely weaker. Consumer discretionary and real estate were among the weakest market sectors in a month of widespread declines. Tech stocks also lagged the market as inflation concerns outweighed short-term optimism over the upcoming earnings season.

EUROZONE

Eurozone shares fell in January amid caution over the outlook for US interest rates and the uncertain situation in Ukraine. There was a sharp divergence between value and growth segments of the market. The MSCI EMU Value Index registered a positive return. Lowly valued areas of the market such as energy and financials were the strongest sector performers.

By contrast, highly valued areas, especially those that had performed well in 2021, were among the main laggards. In particular, within the IT sector, software and semiconductors saw steep falls, as did the healthcare equipment & services subsector.

Soaring food and energy prices contributed to a rise in annual inflation to 5.0% in December, up from 4.9% in November. European Central Bank President Christine Lagarde rejected suggestions that the ECB should start to raise interest rates more quickly than planned in response to the above-target inflation. The ECB said in December that it was very unlikely to raise rates in 2022.

Data showed that eurozone GDP increased by 0.3% quarter-on-quarter in Q4 2021, taking the region's economy back to its pre-pandemic size. The flash eurozone composite purchasing managers' index slipped to an 11-month low of 52.4, given weakness in services due to the Omicron wave, which saw some countries impose restrictions on activity.

The manufacturing sector PMI rose to a five-month high of 59.0. (The PMI indices, produced by IHS Markit, are based on survey data from companies in the manufacturing and services sectors. A reading above 50 signals expansion).

UK

UK equities were broadly unchanged over January. Large cap equities rose, with some sectors recording very strong absolute returns, while small and mid cap equities recorded losses. The internationally diversified large cap resources stocks, and banking and tobacco companies outperformed. These sectors were, respectively, the three largest positive performance contributors as investors rotated towards some deeply out of favour areas of the market.

In contrast to the volatile market conditions, consensus earnings growth estimates for UK quoted companies remained steady in January. Meanwhile, a number of consumer-facing companies were able to deliver positive earnings surprises in the month, notably some of the UK's biggest retailers.

The latest monthly GDP data from the Office for National Statistics revealed that UK output grew a strong 0.9% in November. This was ahead of consensus expectations for growth of 0.4%, and saw the economy recover to its pre-pandemic peak.

Fears that the full impact of inflationary and interest rate trends had yet to fully hit home, however, continued to impact sentiment towards many of the domestically focused companies. Worries around a potential cost of living crisis also weighed on sentiment. Many Covid restrictions introduced before Christmas to tackle the Omicron variant were lifted. Despite this, a number of the companies in the travel and leisure sectors, which are reliant on economies reopening, extended share price losses from last year following negative earnings surprises.

JAPAN

The Japanese stock market ended January with a loss of 4.8%. Small cap indices yet again underperformed the broader market, with particularly sharp declines seen in the technology-focused Mothers market.

The tone for the equity market was set by the release of the minutes from the US Fed meeting, and the associated change in expectations for US interest rates. Although this had a negative impact on sentiment, such a move is still very unlikely to be followed by the Bank of Japan in the foreseeable future.

The change in outlook for US interest rates also helped to accelerate a change in market dynamics. In Japan, this was especially evident in the outperformance of value-style stocks at the expense of growth. Much of this relative gain in value stocks was concentrated in financial-related sectors including banks and insurance

Meanwhile, Japanese inflation remains very subdued and is likely to remain below the Bank of Japan's target even as one-off factors drop out and the full impact of higher energy prices is felt. The primary factor in this is the very low level of wage increases in Japan, without which we are unlikely to see the type of upward spike in inflation that is underway elsewhere.

The other major factor in January was the sharp pick-up in Covid infections, driven by the Omicron variant. The absolute number of infections in Japan has remained remarkably low throughout the pandemic, but the latest variant has again demonstrated a higher level of risk aversion. The government has so far avoided re-imposing the state of emergency, but Japan's borders remain closed to foreigners until at least the end of February. The overall impact of Omicron has been to push out further the expectations for a full recovery of Japan's domestic economy.

ASIA (EX JAPAN)

Asia ex Japan equities recorded a modest decline in January amid a volatile month of trading sparked by the Fed's plan to tackle higher inflation by raising interest rates, starting in March. With investors already concerned about rising oil prices, global supply chain problems and geopolitical tensions between Russia and Ukraine, the prospect of sustained hikes in the cost of borrowing by the world's biggest economy further weakened sentiment towards many Asian markets.

South Korea was the weakest market in the MSCI Asia ex Japan Index, as foreign investors became increasingly risk averse. Chinese shares also ended the month in negative territory as global concerns over the Fed's rate hike plan sparked selling by overseas investors, with losses led by the technology sector. Malaysia also ended the month in negative territory, while declines in India, Singapore and Taiwan were more modest.

The Philippines was the best-performing index market in January, with more muted gains achieved by Hong Kong, Indonesia and Thailand.

EMERGING MARKETS

Emerging market (EM) equities recorded a negative return in January as markets priced in more aggressive policy tightening by the US Fed. South Korea was the weakest market in the MSCI EM index, exacerbated by disappointing Q4 corporate earnings results. Russia was firmly down as tensions with the West in relation to Ukraine continued to rise. China underperformed the index by a smaller margin. Macroeconomic data remained mixed and the authorities announced some modest monetary easing. Mexico, Taiwan, Malaysia and India also finished behind the index.

By contrast, net EM oil exporters, ex-Russia, were beneficiaries of higher energy prices; the result of rising geopolitical tensions in Russia, one of the world's largest oil & gas producers. Saudi Arabia, Kuwait, Qatar, Colombia and the UAE all outperformed in MSCI EM index.

The Latin American markets of Brazil, Chile and Peru all finished ahead of the index. Brazilian equities and the currency rallied as economic activity proved more resilient than markets had anticipated. Meanwhile, ahead of the October presidential election, former president and candidate Luiz Inácio Lula da Silva indicated that he would seek to form a broad alliance. A moderation in political concerns was also supportive of the Chilean and Peruvian markets, as was a pick-up in copper prices.

GLOBAL BONDS

Government bond yields lurched higher in January, while stock markets fell sharply and corporate bonds also declined, as investors focused on continued elevated inflation and impending tightening from the Federal Reserve (Fed). The US dollar index hit its highest level since mid-2020.

Fed Chair Powell's comments during the month indicated the US central bank would consider all options for the future path of policy. Markets took this as paving the way to potentially a more aggressive tightening trajectory. Year-on-year US consumer price inflation registered 7% in December, the highest since 1982.

The US 10-year Treasury yield rose from 1.51% to 1.78%. However, the 2-year yield bore the brunt of the sell-off, rising from 0.73% to 1.18% given its greater sensitivity to interest rates.

The German 10-year yield rose from -0.18% to 0.01%, above 0% for the first time since May 2019. Concerns over the Omicron variant started to fade and numerous European countries eased lockdown measures.

The Italian 10-year yield increased from 1.18% to 1.37%. The country's presidential election saw incumbent Sergio Mattarella returned to office, which the market took as a positive outcome and spreads tightened to core markets.

The UK 10-year yield increased from 0.97% to 1.31% and the 2-year yield from 0.68% to 1%. UK consumer inflation hit a 30-year high of 5.4% in December and raised expectations for a further rate hike in February.

Corporate bonds had a difficult month, registering negative total returns and underperforming government bonds as spreads widened. Europe performed well relative to the US. The European transportation sector did relatively well as numerous countries lifted lockdown measures.

Emerging market (EM) debt saw negative returns. Local currency bond yields rose further, while EM currencies broadly performed well especially in Latin America. Central and eastern European currencies lagged in aggregate. The Russian rouble weakened given political concerns and the threat of sanctions.

EM hard currency (US dollar denominated) bonds saw negative returns, with investment grade sovereign bonds impacted in particular by moves higher in global yields. EM corporate bonds outperformed global credit markets. Investment grade bonds are the highest quality bonds as determined by a credit rating agency; high yield bonds are more speculative, with a credit rating below investment grade.

Amid sharp declines for global equities in January, convertible bonds were able to provide little protection. The Refinitiv Global Focus index of balanced convertible bonds returned -4.1%. The primary market for convertibles saw US$3.4 billion of new paper issued in the month. Convertible bonds valuations became slightly more expensive though most global regions are trading around fair price.

COMMODITIES

The S&P GSCI Index recorded a positive return in January, driven higher by a sharp increase in energy prices during the month. Energy was the best-performing component of the index during the month, with a sharp rise in the price of natural gas and strong gains for gas oil, heating oil and crude oil. Prices were boosted by supply shortages and political tensions in eastern Europe and the Middle East.

The agriculture component achieved a more modest gain in January. Industrial metals achieved a mixed performance over the month, with strong gains for aluminium and nickel, but weaker prices for copper and lead. Precious metals was the only component to record a negative performance over the month, with price declines for both gold and silver.

TOTAL RETURNS (NET) % – TO END JANUARY 2022

	1 MONTH			12 MONTHS		
Equities	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
MSCI World	-5.3	-3.9	-4.4	16.5	26.3	19.3
MSCI World Value	-1.3	0.2	-0.3	21.6	31.8	24.5
MSCI World Growth	-9.3	-8.0	-8.4	11.0	20.3	13.6
MSCI World Smaller Companies	-7.6	-6.2	-6.7	4.8	13.6	7.3
MSCI Emerging Markets	-1.9	-0.5	-1.0	-7.2	0.5	-5.0
MSCI AC Asia ex Japan	-3.1	-1.7	-2.2	-11.3	-3.9	-9.2
S&P500	-5.2	-3.8	-4.3	23.3	33.6	26.2
MSCI EMU	-4.9	-3.5	-4.0	10.3	19.5	12.8
FTSE Europe ex UK	-6.1	-4.7	-5.2	11.2	20.5	13.8
FTSE All-Share	-1.3	0.2	-0.3	16.2	25.9	18.9
TOPIX*	-4.9	-3.5	-4.0	-2.7	5.4	-0.5

	1 MONTH			12 MONTHS		
Government Bonds	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
JPM GBI US All Mats	-1.7	-0.3	-0.8	-3.1	5.0	-0.8
JPM GBI UK All Mats	-4.9	-3.6	-4.0	-9.6	-2.0	-7.5
JPM GBI Japan All Mats**	-0.8	0.6	0.1	-9.8	-2.2	-7.6
JPM GBI Germany All Traded	-2.5	-1.1	-1.6	-10.8	-3.3	-8.7
Corporate Bonds	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
BofA ML Global Broad Market Corporate	-3.0	-1.6	-2.1	-4.9	3.1	-2.6
BofA ML US Corporate Master	-3.1	-1.7	-2.2	-2.9	5.3	-0.6
BofA ML EMU Corporate ex T1 (5-10Y)	-3.3	-1.9	-2.3	-10.5	-3.0	-8.4
BofA ML £ Non-Gilts	-3.8	-2.5	-2.9	-7.2	0.6	-5.0
Non-investment Grade Bonds	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
BofA ML Global High Yield	-2.7	-1.3	-1.8	-1.4	6.8	0.9
BofA ML Euro High Yield	-1.4	0.0	-0.5	-6.2	1.6	-4.0

Source: Thomson Reuters DataStream.
Local currency returns in January 2022: *-4.8%, **-0.8%.
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Source: Schroders, January 2022: The value of investments and the income from them may go down as well as up and investors may not get back the amounts originally invested. Past performance mentioned is not a guide to future performance and may not be repeated. The sectors, securities, regions and countries shown are for illustrative purposes only and are not to be considered a recommendation to buy or sell.

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